

**DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 97-0442
STATE CIGARETTE TAX
For 1993, 1994, and 1995**

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ISSUE

I. Cigarette Tax – Imposition

Authority: IC § 6-7-1-1; IC § 6-8.1-5-4; *Indiana Eby-Brown Co. v. Indiana Department of Revenue*, 648 N.E.2d 401 (Ind. Tax 1995)

Taxpayer protests the imposition of cigarette tax on cigarettes taxpayer reported exported from Indiana.

STATEMENT OF FACTS

Taxpayer is an Indiana Corporation that distributes cigarettes, tobacco products, and sundry items throughout Indiana and 3 other states, including Kentucky. During the audit period the Department inspected taxpayer's monthly cigarette tax returns and determined that the number of cigarettes reported exported to Kentucky on the Indiana cigarette returns was greater than the number of cigarettes reported imported, taxed, and sold on taxpayer's Kentucky cigarette returns for 1993, 1994, and 1995. The audit attributed the missing cigarettes to Indiana and assessed Indiana cigarette tax on them. Taxpayer is protesting this adjustment.

I. Cigarette Tax - Imposition

DISCUSSION

The overlying issue for the taxpayer's protest is the audit's assessment of tax based on inferences drawn from taxpayer records and tax returns from both Indiana and Kentucky. Taxpayer contends that the inferences resulting in assessment were not properly drawn. This issue revolves around the burden of proof in an audit situation, which IC § 6-8.1-5-4 defines as:

Every person subject to a listed tax must keep books and records so that the department can determine the amount, if any, of the person's liability for that tax by reviewing those books and records. The records in this subsection include *all source documents necessary to determine the tax*, including invoices, register tapes, receipts, and canceled checks. (*Emphasis added*)

Taxpayer does not cite any statute, regulation, or case law for the proposition that the auditor was required to accept assertions as to the nature of the transactions based solely on the returns taxpayer filed in Indiana. Taxpayer's assertion that the auditor was required to ignore conflicting documentation is not sustainable.

Taxpayer next argues that the discrepancy in the number of cigarettes reported shipped from Indiana and the number of cigarettes reported delivered to Kentucky is irrelevant to the Indiana audit, and that by implication the cigarettes 'disappeared' in interstate commerce and were thus not subject to taxation. The cigarette tax is imposed by IC § 6-7-1-1, which provides:

It is the intent and purpose of this chapter to levy a tax on all cigarettes sold, used, consumed, handled, or distributed within this state, and to collect the tax from the person who first sells, uses, consumes, handles, or distributes the cigarettes. It is further the intent and purpose of this chapter that whenever any cigarettes are given for advertising or any purpose whatsoever, they shall be taxed in the same manner as if they were sold, used, consumed, handled, or distributed within this state. Notwithstanding any other provisions contained in this chapter. The liability for the excise taxes imposed by this chapter shall be conclusively presumed to be on the retail purchaser or ultimate consumer, precollected for convenience and facility only. When such taxes are paid by any other person, such payment shall be considered as an advance payment and shall be added to the price of the cigarettes and recovered from the ultimate consumer or user.

The Indiana Tax court addressed a challenge to the scope of this law, focusing on the issue of "shrinkage," which both parties stipulated to mean:

Theft and shrinkage, prevalent problems in the cigarette industry, "occur through the complicity of the employees of the distributors and ... prevail even though many precautionary methods are installed by distributors, such as surveillance cameras, tight entrance and exit security requirements, locked cages for storing cigarettes, periodic lie detector tests, anti-theft devices, more frequent inventory taking, etc." *Joint Stipulation* at ¶6. *Indiana Eby-Brown Co. v. Indiana Department of Revenue*, 648 N.E.2d 401 (Ind. Tax 1995) at 402

After review of the IC § 6-7-1-1 the court determined in *Indiana Eby-Brown Co. v. Indiana Department of Revenue*, 648 N.E.2d 401 (Ind. Tax 1995) at 406:

For the foregoing reasons, this court holds that it is the legislature's intent to tax all cigarettes to be "sold, used, consumed, handled, or distributed" within the state,. Accordingly, the Department properly assessed to Eby-Brown a cigarette

tax on cigarettes lost, stolen, or otherwise missing from its possession. Thus, the Department's final determination is **AFFIRMED**.

Taxpayer fails to address the chronology of these 'disappearances' in the protest. The cigarettes 'disappeared' totaled 97,825 in 1993, 516,050 in 1994, and 468,785 in 1995. This fivefold increase in annual losses after 1993 is not explained by taxpayer. Indeed, the only event of significance that occurred in 1993 related to this issue was a Letter of Finding issued to this taxpayer requiring the payment of cigarette tax on cigarettes that disappeared due to shrinkage, said interpretation of the law later being sustained in *Eby-Brown*.

As *Eby-Brown* holds, cigarettes consumed or distributed in this state, regardless of the circumstances surrounding their consumption, are taxable by this state. If 1,082,660 cigarettes disappear, shrinkage was involved. If the cigarettes last reported location was Indiana; then they were consumed or distributed in Indiana. Taxpayer's effort to transfer the shrinkage totals to interstate commerce is not sustained.

FINDING

Taxpayer protest denied.